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IN THE

Supreme Court of the United States

OCTOBER TERM, 1936.

No. 354.

In the Matter

of

UNITED CIGAR STORES COMPANY OF AMERICA,
Debtor.

CAROLINE R. KUEHNER and FREDERICK G. FISCHER, as trustees,
Petitioners,

GRAYSON M.-P. MURPHY, *et al.*, as a Preferred Stockholders Protective Committee, *et al.*,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR PETITIONERS.

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BRIEF FOR PETITIONERS.

OPINIONS BELOW.

The opinion of the District Court appears at page 146 of the record and is not officially reported. The opinion of the United States Circuit Court of Appeals is reported at 85 F. (2d) 35.

JURISDICTION.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925. The order for mandate was entered on July 20, 1936. The petition for certiorari was filed September 10, 1936, and granted October 26, 1936.

QUESTIONS PRESENTED.

This case involves the interpretation and constitutionality of the limitation on landlords' claims in corporate reorganization proceedings under Section 77B of the Bankruptcy Act.*

The petitioners' claim arises out of a lease of real estate between their predecessors, as lessors, and the debtor corporation, as lessee, which, when it still had about fourteen years to run, had been rejected by the debtor's trustee in bankruptcy proceedings in which the 77B proceedings were subsequently instituted. After the rejection of the lease and before the enactment of Section 77B, the petitioners reentered under a covenant (R. 57), which provided that in such case the lease should terminate and the debtor should:

"indemnify the Landlords against all loss of rent

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* Relevant portions of the statute are quoted below at pp. 4-5. The limitation provision provides:

> "The claim of a landlord for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall be treated as a claim ranking on a parity with debts which would be provable under section 63(a) of this Act, but shall be limited to an amount not to exceed the rent"

reserved by the lease for a period of three years after the surrender of the premises to the landlord or the landlord's reentry, plus accrued, unpaid rent.

which the Landlords may incur by reason of such termination, during the residue of the term above specified."

The petitioners' claim, measured by the difference between the rent reserved and the present rental value of the premises for the unexpired term, was established by uncontradicted testimony at $87,692.30, subject to appropriate discount.* The courts below allowed the petitioners' claim on a parity with other claims against the debtor, in the amount of $44,377.55, the amount of three years' rent**, but rejected the petitioners' contention that the balance of their claim should be recognized in the reorganization proceedings in subordination to other creditors but *in priority to the debtor's stockholders.* On this state of the case, the following questions are presented:

1. Should the provision of Section 77B limiting landlords' claims be interpreted as limiting only the amount in which the petitioners' claim is allowable on a parity with other debts, permitting the balance of the claim to be allowed in subordination to other debts but in priority to the debtor's stockholders?

2. If the balance of the claim over three years' rent is not presently allowable, even in a subordinate

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* By understanding of the parties, all questions as to discount and interest have been reserved for future determination. The petitioners' claim, even after being discounted on any reasonable basis, still would exceed three years' rent by a substantial amount.

** The term "three years' rent", as used herein, includes accrued unpaid rent up to the date of surrender or reentry, as provided in the statutory formula.

position, are the petitioners entitled to have their rights against the debtor and its assets reserved in priority to the debtor's stockholders, to the extent that their loss turns out to exceed the amount of three years' rent?

3. If the statute is interpreted as restricting the petitioners' right to participate in the reorganization to the allowance of the claim in an amount equal to three years' rent, even although stockholders participate in the reorganization, is the statute to that extent unconstitutional as beyond the power of Congress under the Bankruptcy Clause and in contravention of the Fifth and Tenth Amendments?

THE STATUTE.

Section 77B of the Bankruptcy Act provides:

"Sec. 77B. Corporate Reorganizations * * *.

(b) * * * (10) * * * The term 'creditors' shall include for all purposes of this section and of the reorganization plan, its acceptance and confirmation, all holders of claims of whatever character against the debtor or its property, including claims under executory contracts, whether or not such claims would otherwise constitute provable claims under this Act. The term 'claims' includes debts * * * or other interest of whatever character. * * *

In case an executory contract or unexpired lease of real estate shall be rejected pursuant to direction of the judge given in a proceeding instituted under this section, or shall have been rejected by a trustee or receiver in bankruptcy or receiver in equity, in a proceeding pending prior to the institution of a proceeding under this section, any person injured by such rejection shall,

for all purposes of this section and of the reorganization plan, its acceptance and confirmation, be deemed to be a creditor. The claim of a landlord for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall be treated as a claim ranking on a parity with debts which would be provable under section 63(a) of this Act, but shall be limited to an amount not to exceed the rent, without acceleration, reserved by said lease for the three years next succeeding the date of surrender of the premises to the landlord or the date of reentry of the landlord, whichever first occurs, whether before or after the filing of the petition, plus unpaid rent accrued up to such date of surrender or reentry. * * *

(h) Upon final confirmation of the plan, * * * the property dealt with by the plan * * * shall be free and clear of all claims of the debtor, its stockholders and creditors, except such as may consistently with the provisions of the plan be reserved * * *. Upon the termination of the proceedings a final decree shall be entered * * *. Such final decree shall discharge the debtor from its debts and liabilities, and shall terminate and end all rights and interests of its stockholders, except as provided in the plan or as may be reserved as aforesaid. * * *"

(Act approved June 7, 1934, 48 St. 911, Ch. 424, §1; U. S. C. Tit. 11, §207.)

THE FACTS.

The lease to the debtor, covering premises situated in New Jersey, was entered into in 1926 for a term expiring in 1946, at a net annual rental of $10,500 for the first ten years and $11,500 thereafter (R. 46).

On August 29, 1932, the debtor filed its voluntary petition in bankruptcy, was adjudicated and abandoned the premises. On November 14, 1932, the trustee in bankruptcy rejected the lease and abandoned the premises and on the following day the landlords reentered (R. 6, 40), thus terminating the lease (R. 57). The lease obligated the debtor in such event to indemnify the landlords against all loss of rent which they might incur by reason of such termination during the residue of the term (R. 57).

The debtor's petition for reorganization under Section 77B was filed in the bankruptcy proceedings on June 9 and approved on June 14, 1934. The petitioners filed a proof of claim (R. 4) praying that their claim "based upon or arising out of the lease * * * or for injury resulting from the rejection of said lease by the Trustee in Bankruptcy * * * or for damages or indemnity under a covenant or covenants contained in said lease", measured by the difference between the rent reserved and the rental value for the remainder of the term, be allowed on a parity with provable debts to the extent of three years' rent and that the balance be allowed in subordination to provable debts but in priority to the claims or interests of the stockholders of the debtor.

The reorganization trustee objected, asking that the claim be reduced to an amount "limited as provided by the statute" (R. 15).

At the hearing, committees representing preferred stockholders and debentureholders of the debtor objected to the allowance of the claim in any amount (R. 21) on the ground that the petitioners could not sue on the covenant of indemnity until the expiration of the term. Thereupon the petitioners amended the proof of claim so as to pray that, to the extent that any part of the claim should be held not provable,

a charge be reserved against the debtor's assets, at least in priority to any interest accorded to stockholders (R. 25).

The fair rental value of the premises for the balance of the term is $111,545.36 (R. 73). The expert testimony establishing this value was not controverted. The future installments of rent under the lease for the remainder of the term (including taxes and other items payable as additional rent) aggregate $199,237.66.

THE RULINGS BELOW.

The Special Master reported that the petitioners' claim was valid and should be liquidated according to the customary formula of difference between rent reserved and rental value. He found that the total claim, on that basis, would be not less than an amount equal to three years' rent, and he recommended (1) that the claim should be allowed on a parity with provable debts to the extent of three years' rent, to wit, $44,377.55 and (2) that all questions as to the balance of the claim should be reserved until the time of the classification of creditors and the consideration of a reorganization plan (R. 88, 93). The Special Master stated (R. 88):

> "Whether there will be a surplus over and above the amount of provable claims and expenses of administration, how the same is to be distributed and, in fact, the method of payment and manner thereof to the various creditors, will depend upon the classification of creditors and the respective rights of the various interested parties herein. All these matters will only be presented when the time for classification arrives, and when various questions arise in the consideration and the confirmation of any Plan of Reorganization."

The District Court confirmed the Special Master's report "with the exception that the claim as allowed shall represent the extent of claimant's right to participate in these proceedings" (R. 146). The order entered in the District Court (R. 116-118) provided that the report of the Special Master

> "be, and the same is, approved and confirmed, with the exception that the extent of the claimants' right to participate in these proceedings shall be limited to the amount found by said report to be allowable, to-wit, $44,377.55."

On cross appeals, the Court of Appeals affirmed (R. 150).

SPECIFICATION OF ERRORS.

The Court of Appeals erred in holding:

(1) that the limitation provision prohibited the allowance of the balance of petitioners' claim over three years' rent in subordination to provable debts but in priority to the interest of stockholders;

(2) that the limitation provision prohibited the reservation of the petitioners' residual rights in priority to the interest of stockholders;

(3) that the limitation provision as so interpreted was a valid exercise of the bankruptcy power and did not violate the Fifth Amendment;

(4) that the petitioners had no standing to complain that other landlord creditors similarly situated would receive more favorable treatment than the petitioners as a result of the operation of the limitation provision as so interpreted.

SUMMARY OF ARGUMENT.

The limitation provision does not prescribe a short-cut method for liquidating landlords' claims. The statute requires that the landlord's loss over the entire unexpired term be determined by judicial process, without regard to any supposed difficulties of liquidation and before the "limitation" is applied. The formula adopted by the Court of Appeals for the liquidation of the petitioners' claim is the only one used or suggested in the American or English precedents and has been called "familiar and fair" by this Court. It is entirely reliable, since the *present rental value* of *future terms* is a fact ascertained and relied on in daily business activities (I, pp. 12-16).

The limitation provision was intended, not to fix the maximum amount of a landlord's claim, but merely to limit the portion of the claim which is to be treated on a parity with other debts. It was not designed for the benefit of stockholders and should not be interpreted as attempting to overthrow the fundamental principle that even contingent creditors are entitled to resort to the corporate assets in priority to stockholders. Therefore, the balance of the petitioners' claim in excess of three years' rent should be allowed in subordination to other debts but in priority to the interest of stockholders. Such interpretation is consistent with the language of the limitation provision, is indicated by the general structure of the statute, its background, legislative history and underlying purposes, and is required in order to avoid questions as to the constitutionality of the limitation provision (II, pp. 17-28).

If the balance of the claim is not presently allowable, even in subordination to other debts, the statute requires that the petitioners' rights be reserved in

priority to stockholders, to the extent that their loss turns out to exceed the amount of the claim allowed on a parity with other debts (III, pp. 29-30).

As interpreted below the limitation provision is not within the bankruptcy power since it is neither necessary nor reasonably adapted to the end in view—effective reorganization of embarrassed corporations (IV, pp. 32-38). Even if within the general scope of the power, the limitation provision as so interpreted violates the due process clause because of its arbitrary and discriminatory operation and because it deprives the petitioners of their rights by legislative decree (IV, pp. 38-46).

The limitation provision as so interpreted inflicts legal injury upon the petitioners, who have not waived and are not estopped to assert its unconstitutionality (V, pp. 46-51).

The balance of the petitioners' claim over three years' rent should be allowed in priority to the interest of stockholders or the disallowance of such balance should be without prejudice to the petitioners' right to demand appropriate reservation of their rights as against stockholders (VI, p. 52).

ARGUMENT.

The courts below have held that the petitioners' claim, measured by the difference between the future rent instalments, discounted, and the present value of the remaining term, is entitled to recognition in the 77B proceedings, subject only to limitation to an amount equal to three years' rent. The respondents do not challenge that holding, nor have they at any time questioned the rental value of the premises as established by the petitioners' witnesses.

There has been no determination that the debtor is insolvent, nor has its insolvency even been alleged. No evidence was adduced at the hearing as to the value of the debtor's assets or the amount of its liabilities. No plan for the reorganization of the debtor has been proposed.

Nevertheless, the preferred stockholders of the debtor, and the trustee on their behalf, have contended (so far with success) that the debtor's stockholders are entitled to participate in the benefits of whatever reorganization may be effected, without the recognition of more than a fraction of the petitioners' claim, no matter how large may be the "equity" thus created for the stockholders.

The Court of Appeals sustained the limitation of the petitioners' rights for the benefit of the debtor's stockholders solely because of supposed difficulties in liquidating their claim, despite the facts that the statute requires the liquidation of the claim and the court itself selected the formula for its liquidation. The Court of Appeals mistakenly assumed that the liquidation of such claims depends upon prophecy or mere guess-work as to the future rental value of the leased properties, and intimated that Congress may have desired to restrict the period of such forecasting to the near future.

The question of liquidation thus lies at the threshold of the case and we propose to discuss it first, and then address our attention to the interpretation and constitutionality of the limitation provision.

I.

The statute requires that the petitioners' entire claim be liquidated by judicial process: it may be liquidated on a basis "familiar and fair".

The limitation provision does not purport to give every landlord a claim equal to three years' rent. The provision obviously requires that the landlord's claim be liquidated by judicial process; that the result so arrived at, if not in excess of three years' rent, shall be the measure of his claim; but that if such result is in excess of three years' rent, the limitation then shall be applied.

The Court of Appeals stated the correct formula for the measurement of the petitioners' claim as the difference between the total rent reserved, discounted, and the appraised value of the remaining term. As the court pointed out in its opinion, if that method were not adopted, the claim could not be liquidated at all (R. 152).

The formula thus adopted is the only one which has ever been used or even suggested for determining damages for loss of future rent or the present value of a covenant to indemnify against loss of rent.* It is the method uniformly used by the English courts**

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* *Leo* v. *Pearce Stores Co.*, 54 F. (2d) 92, 57 F. (2d) 340; *McGraw* v. *Union Trust Co.*, 135 Mich. 609; *Kalkoff* v. *Nelson*, 60 Minn. 284; *In re Reading Iron Works*, 150 Pa. St. 369; *Curran* v. *Smith-Zollinger Co.*, 18 Del. Ch. 220; *cf. Bowditch* v. *Raymond*, 146 Mass. 109.

** *Ex Parte Blake*, 11 Ch. Div. 572; *Ex Parte Llynvi Coal & Iron Co.; In re Hide*, L. R. 7 Ch. App. 28; *Ex Parte Leather Sellers' Co.*, 3 Morrell 126; *In re Panther Lead Co.*, [1896] 1 Ch. Div. 978; *cf. In re Carruthers*, 15 Reports 317, 2 Mansons 172.

under the similar provisions of the English bankruptcy statutes,* irrespective of the type of covenant contained in the lease, and even though the English statute, like Section 77B, contains no direction as to the method of liquidation.

In the case at bar, the Court of Appeals felt that when the formula is agreed to by the parties, it is thoroughly reliable and even entitled to protection under the constitution (R. 156). It is difficult to perceive how the formula can be more reliable when provided for by agreement than when adopted by the courts as the only judicial method available. This Court, when holding in *Wm. Filene's Sons Co.* v. *Weed*, 245 U. S. 597 (at p. 602), that a lease covenant prescribing the use of the formula liquidates the landlord's damages on a basis "familiar and fair", cited cases in which the courts had applied the formula although no method of liquidation had been agreed upon.

The decisions of this Court in *Manhattan Properties, Inc.* v. *Irving Trust Company*, 291 U. S. 320, and *Miller* v. *Irving Trust Company*, 296 U. S. 256, that landlords' claims based on similar covenants of indemnity were not provable in bankruptcy before the 1934 amendment to Section 63(a), are not con-

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* 46 and 47 Vict., c. 52, provided:

"Any person injured by the operation of a disclaimer under this section shall be deemed to be a creditor * * *."

See also 4 and 5, Geo. V, c. 59.

"We take our bankruptcy system from England, and we naturally assume that the fundamental principles upon which it was administered were adopted by us when we copied the system. * * *" (*Sexton* v. *Dreyfus*, 219 U. S. 339, 344.) See also *Willis* v. *Eastern Trust and Banking Co.*, 169 U. S. 295, 307.

trolling. The statute before the Court in those cases, unlike Section 77B, did not expressly recognize such claims or require their liquidation.*

Although approving the use of the customary formula for the liquidation of the claim, the Court of Appeals felt that it is not entirely reliable, due to the difficulty of prophesying the "future value" of realty (R. 153). This feeling was unjustified. In applying the formula, the problem is not to guess the future rental value of the property for successive short periods over the balance of the term, but merely to ascertain the amount for which the property could have been rented, at the date as of which the formula is applied, for a single period running until the end of the term stipulated in the old lease. The *present rental value* of real property for a *future term* is an existing fact the determination of which does not depend on prophecy or future valuation. It is true

* In *Miller* v. *Irving Trust Company*, the covenant required the tenant to pay to the landlord, on each rent day, the difference between the amount of rent reserved in the lease and whatever amount may have been collected by the landlord on a reletting. This Court, in holding that the landlord was not entitled (before the amendment) to prove a claim measured by the difference between rent reserved and rental value, apparently took the view that the landlord was not required to relet at current rental values and, therefore, current rental values could have no relevancy in the adjudication of his rights. In the case at bar, the debtor has agreed to *indemnify* the landlord against *loss* of rents. Under such a covenant, the landlord is required to act diligently and prudently in reletting the property; if he declines a fair offer at the current rental value, he nevertheless is charged with the amount he could have obtained in ascertaining the loss that he is entitled to recoup from the tenant (*Lenco, Inc.* v. *Hirschfeld*, 247 N. Y. 44, 50; *Fitch* v. *Armour*, 14 N. Y. S. 319; *Edmands* v. *Rust & Richardson Drug Company*, 191 Mass. 123; see, also, *International Trust Company* v. *Weeks*, 203 U. S. 364; *cf. Curran* v. *Smith-Zollinger Company*, 18 Del. Ch. 220). Consequently, under such a covenant the recognition of a claim measured with reference to current rental values does not require a material departure from the terms of the contract.

that in some cases expert testimony must be resorted to, but that does not depend on the gift of prophecy; it represents, rather, an opinion of one qualified to speak as to a past or present fact. And expert opinion is not the only or always the best evidence of rental value; if the landlord, exercising reasonable diligence, has succeeded in rerenting the property for the balance of the term that fact would constitute the best evidence (*Curran* v. *Smith-Zollinger Co., supra*).

Nor does the use of the formula involve an attempt to forecast the amount of rent the landlord will lose over the remainder of the term. As the Court of Appeals said (R. 152), the method adopted is the same as is used in cases involving breaches of executory contracts for chattels and that method must be adopted or the claim cannot be measured at all. The computation of damages for breach of an executory contract for chattels is not influenced by the probability that the actual loss may turn out to be greater or less, or even by the known fact that, because of some circumstance intervening the breach and the award, the predicted loss actually has been turned into a profit (*In re Susquehanna Silk Mills,* 10 F. Supp. 787, aff'd 77 F. [2d] 1015).

This Court will take judicial notice that leases of real property are made every day in the ordinary course of business. Every such lease is made for a future term and many are made for very long terms. The petitioners' predecessors and the debtor in the case at bar made such a deal in 1926 when one agreed to pay and the other agreed to accept an average annual net rental of $11,000 for the property here involved, over a period of twenty years. In every such transaction, the *present rental value* for a *future term* is determined as a practical matter

and for practical purposes. A fact which business men ascertain and rely on every day in the course of their usual business activities cannot be as unreliable as the Court of Appeals appears to consider it.

The Court of Appeals was wrong in intimating that Congress may have intended or desired to "circumscribe" the use of the formula to "the near future" or to fix a period of "four or five years" "as the maximum forecast which it would be safe to act on" (R. 153-4). The fact is that Congress did not do so. The statute, even as interpreted by the Court of Appeals, requires the landlord's entire claim to be measured with reference to the current rental value of the property over the *entire remainder of the term* (fourteen years, in the case at bar), and requires that the result so arrived at be adhered to, provided only it does not exceed the arbitrary maximum of three years' rent. Clearly, if the formula adopted had produced a result less than three years' rent the petitioners would have been bound by it.

We conclude, therefore, that the method of liquidation adopted by the Court of Appeals is the proper method for the measurement of the petitioners' claim; that Congress intended that the entire claim for the entire balance of the term be so measured and liquidated, however long the "forecast" might be; and that Congress intended that the method of liquidation so adopted should fix the extent of the petitioners' rights to participate in the reorganization, subject only to the arbitrary limitation.

II.

The balance of the petitioners' claim over three years' rent is allowable in subordination to provable debts but in priority to the interests of stockholders.

Despite the fact that the petitioners' claim was not provable in the prior bankruptcy proceedings of the debtor and was contingent and unliquidated, the petitioners were creditors. Their contract right to look to the debtor or its assets for indemnity against loss of rent would not have been extinguished by a discharge in bankruptcy; or by the voluntary liquidation of the debtor (*Pierce* v. *United States,* 255 U. S. 398); or by insolvency or winding up proceedings under the law of New Jersey, the state of incorporation of the debtor (*Block* v. *Bell Furniture Co.,* 111 N. J. Eq., 551); or by any form of reorganization (*Northern Pacific Railroad Company* v. *Boyd,* 228 U. S. 482; *Howard* v. *Maxwell Motor Co., Inc.,* 269 Fed. 292, aff'd 275 Fed. 53; see *Landlords' Claims in Reorganization,* 42 Yale L. J., 1003, 1015-1026).*

No statute theretofore enacted "for the relief of debtors" or for any other purpose had attempted to upset the established principle under which even contingent creditors are protected as against stockholders.** The controlling canon of statutory construction to be applied in such a case was announced by

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* *Block* v. *Bell Furniture Co.* and *Howard* v. *Maxwell Motor Co., Inc.* involved landlords' claims for loss of rent.

** See, for instance, *Kalkoff* v. *Nelson, supra; Block* v. *Bell Furniture Co., supra; In re Mechanics Trust Co.,* 119 N. J. Eq. 141; N. Y. Insurance Law, Sec. 425.

Chief Justice Marshall in *United States* v. *Fisher*, 2 Cranch. 358, at page 388:

> "Where rights are infringed, where fundamental principles are overthrown, where the general system of the laws is departed from, the legislative intention must be expressed with irresistible clearness, to induce a court of justice to suppose a design to effect such objects."

The limitation provision contains no clear expression of a design to benefit stockholders at the expense of contingent creditors. The language may be ambiguous, but it is at least susceptible of an interpretation giving the full amount of a landlord's loss priority over the debtor's stockholders. Moreover, the background, legislative history and underlying purposes of Section 77B indicate that Congress had no intention of attempting to overthrow the fundamental principles above referred to.

Finally, the interpretation which we urge should be adopted in order to avoid questions as to the constitutionality of the statute (*infra*, pp. 31-46).

A. *The Background and Purpose of the Limitation on Landlords' Claims.*

In arriving at the correct interpretation of the limitation provision, it is important to consider the time when and the circumstances under which the special provisions relating to landlords' claims were inserted in Section 77B and, by amendment, in the general Bankruptcy Act.

Manhattan Properties Inc. v. *Irving Trust Company, supra*, involving the provability in bankruptcy of landlords' claims for loss of future rents, was

argued and decided in this Court while the bill which eventually became Section 77B was pending in Congress.

The petitioners in that case called attention to the growing epidemic of chain store bankruptcies being engineered for the purpose of obtaining relief from burdensome leases and pointed to recent articles in legal periodicals deploring the situation.*

Counsel for Irving Trust Company stressed the superior rights of general creditors. They stated that "banks, merchandise creditors and others in granting credit have assumed that, in case of any insolvency, the tangible assets of the borrower would be available for such creditors to the exclusion of landlords asserting claims for loss of future rent." They stated that to overturn the existing practice would "require banks, manufacturers, merchants and others extending credit to reconsider and revise all existing lines of credit" which might "well precipitate bankruptcies which would not otherwise occur".

Counsel for the National Association of Credit Men and counsel for a committee of merchandise creditors filed briefs as *amici curiae,* and urged the same considerations. None of those counsel advanced for the consideration of this Court any rights or equities of chain store *stockholders* over landlord creditors. On the contrary, it was well understood that, if landlords' claims were held not provable they would not be discharged, but would continue as valid, subsisting obligations of the bankrupt corporations, and that the landlords' priority over stockholders could not be defeated by any form of corporate reorganization

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* See, for example, 42 Yale L. J. 1003; 33 Col. L. R. 231; 7 Univ. of Cinn. L. R. 164.

effected in connection with the bankruptcy proceedings.*

The problem before Congress was to put an end to the intolerable situation in which many landlords had been placed, without at the same time injuring the commercial credit of tenants by too liberal treatment of landlords. That object could be and was accomplished easily in the amendment to Section 63(a) enacted as a part of the bill containing the corporate reorganization provisions, by limiting the extent to which landlords' claims should be provable, leaving any excess claims both non-provable and non-dischargeable and fully protected by "the rule in the *Boyd* case."

We submit that the same object, and nothing more, was intended to be accomplished by the limitation on landlords' claims in corporate reorganization proceedings. There is no evidence that Congress desired to benefit stockholders. On the contrary, on January 6, 1933, Representative Celler made some scathing remarks on the floor of the House as to the pending bankruptcy proceedings of this debtor, United Cigar Stores Company of America, and other chain stores (76 Cong. Rec., Pt. 2, p. 1360). Representative Celler said that he was introducing a bill "to prevent

* In a footnote at page 49 of the brief for Irving Trust Company in the *Manhattan Properties* case the following statement was made:

> "Petitioner's brief (p. 33) argues that under the existing practice a corporate tenant with sufficient assets to pay all other classes of creditors may, for the purpose of escaping liability on leases, file a voluntary petition in bankruptcy. The argument assumes that the corporation or its stockholders can through bankruptcy benefit at the expense of those having prior rights. In this connection see *Northern Pacific Railway Co.* v. *Boyd*, 228 U. S. 482; 'Landlord Claims in Reorganization' by William O. Douglas and Jerome Frank, 42 Yale Law Journal 1003 (1933)."

the recurrence of such scandals as grew out of the United Cigar Stores bankruptcy" by making landlords' claims provable. While that bill was not enacted, its provisions were very similar to the landlord provisions of Section 77B as originally passed in the House (*ibid.*).

This historical background of the legislation now before the Court cannot be ignored. It discloses the situation with which Congress was required to deal and the evils which it desired to remedy. The resulting enactment should not be interpreted as accomplishing more far-reaching results, unless required by the clearest and most compelling language.

B. *The Language and Legislative History.*

The general structure of Section 77B supports the interpretation that the limitation provision limits only the part of the claim allowable on a parity with provable debts, and was not intended to confer a windfall on stockholders.

Subdivision (b) defines "creditors" as including "all holders of claims of whatever character against the debtor or its property, including claims under executory contracts, whether or not such claims would otherwise constitute provable claims under this Act" and defines "claims" as including "debts * * * or other interest of whatever character". The statute then specifically provides that any person injured by the rejection of an unexpired lease in the reorganization proceedings or in prior proceedings shall "*for all purposes of* this section and of *the reorganization plan,* its acceptance and confirmation, be deemed to be a creditor". These provisions clearly establish the landlord's status as a creditor to the full extent of his injury, damages or right to indemnity. The

intent to restrict that status by other provisions can be shown only by equally clear and unambiguous language.

There is no language anywhere in the statute which, in express terms, limits the landlord's status as a creditor. The limitation provision is contained in the succeeding sentence which deals only with the relative rank of his claim as compared with other debts. It is merely a subordinate proviso clause which should be read as limiting only the sentence to which it is attached (*cf. United States* v. *Morrow,* 266 U. S. 531, 535). To interpret it as restricting the landlord's general status as a creditor would make it conflict with and override the earlier provisions quoted above.

Indeed, the fact that the limitation provision requires that the landlord's claim be treated on a parity with provable debts, subject to limitation in amount, indicates the positive intention of Congress that the balance of the claim, if any, be accorded subordinate treatment. Nowhere else in the statute is the rank or priority of claims prescribed (except the priority of certain unsecured claims over mortgage liens). Therefore, in the absence of liens or statutory or contractual priorities, all claims allowed in the reorganization proceeding rank equally, whether or not they would be provable under Section 63(a). The limitation provision was designed to deny to a portion of landlords' claims the rank they otherwise would have enjoyed by virtue of the general operation of the statute. But if it is interpreted as fixing the amount of such claims for all purposes, the reference to parity is useless verbiage, as the Court of Appeals admits (R. 153).

The legislative history also supports the interpretation here urged.

The bill, as originally passed by the House, allowed landlords' claims in full, without restriction as to either amount or rank (H. R. 5884, June 2, 1933, p. 10).

The limitation provision was originally inserted in the bill on the floor of the Senate (H. R. 5884, May 7, 1934, p. 11) and provided merely that the landlord's claim "shall not be treated as a claim ranking on a parity with debts which would be provable under section 63(a) of this Act, except up to an amount equal to [one year's rent], but the balance, if any, of such claim shall be subordinated in rank to debts so provable". Quite clearly that provision was concerned only with the rank, and not at all with the amount, of the landlord's claim. The history of the development of the provision into its final form does not indicate that its original purpose and scope were intended to be broadened.

The House refused to accept the Senate amendment and the bill went to conference. The difference which was required to be compromised in conference related only to the amount allowable on a parity with provable debts, *neither the House nor the Senate having suggested the destruction of any part of the claim.* If the limitation provision as finally enacted be interpreted as limiting only the parity rank of landlords' claims, it represents a fair compromise between the positions of the two branches of Congress.*

The interpretation of the statute urged by the respondents requires us to assume that the Conferees took it upon themselves to eliminate from the bill the unlimited recognition of landlord's claims which already had been agreed to by both houses. The as-

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* The House bill—full parity.
The Senate amendment—one year's parity.
The compromise—3 years' parity

sumption is entirely unjustified; there was no reason for the Conferees to make such a radical departure, and there is nothing in the Committee Reports or elsewhere in the legislative history which indicates their intention of doing so.

The respondents' argument emphasizes the one word "limited". But the question at issue is not as to the meaning of that word, but is merely whether the *amount* of landlords' claims or their ***rank*** was intended to be limited. This can be determined from the reports of the Conference Committee which framed the limitation provision as finally enacted.

On May 24, 1934, the Conference Committee submitted a report (H. R. Rep. 1773, 73d Congress, 2d Sess., p. 2) in which it recommended a compromise clause providing merely that a landlord's claim should "*be treated as a claim ranking on a parity with debts which would be provable under section 63(a) of this act in an amount equal to*" three years' rent. In their explanation of the clause thus agreed upon in conference, the House Managers made the following statement (*ibid*, p. 5):

> "Amendment No. 14: Under the House Bill, executory contracts, including claims for future rent, are made provable claims for the purposes of this section. *The Senate Amendment limited claims for future rent* to an amount equal to the rent reserved by the lease for 1 year.
>
> "The amendment agreed to by conference makes any person injured by the rejection of an executory contract or unexpired lease of real estate a creditor for the purposes of this section. *The claim of the landlord* for injury resulting from loss of future rents *is limited to an amount not to exceed the rent* reserved by the lease *for*

3 years next succeeding the date of surrender of the premises or the date of reentry of the landlord, whichever first occurs, plus unpaid rent accrued up to such date of surrender or reentry of the landlord * * *." (Italics ours.)

It will be observed that this statement described the Senate amendment as *limiting* landlords' claims *to an amount equal to* one year's rent, although the Senate amendment clearly permitted any balance over one year's rent to be allowed in subordination to other claims. The House Managers also described the language then being recommended by the Conferees as *limiting* landlords' claims *to an amount not to exceed* three years' rent, although such language did not contain the word *"limited"* but merely provided that landlords' claims should be *treated on a parity* with provable debts *"in an amount equal to"* three years' rent. It is quite clear that the House Managers could have intended, in both instances, to refer only to a *limitation of the parity ranking* of landlords' claims as against other creditors.

The Conference Report above referred to was superseded, on May 29, 1934, by a second Conference Report (H. R. No. 1821, p. 2) in which the Conferees recommended the provision which was finally enacted and which differed from the provision they had first recommended by the substitution of the words "shall be treated as a claim ranking on a parity with debts which would be provable under section 63(a) of this act, but shall be limited to an amount not to exceed [3 years' rent]" for the words "shall be treated as a claim ranking on a parity with debts which would be provable under section 63(a) of this act in an amount equal to [3 years' rent]". The words *"limited to an amount not to exceed"* were taken *verbatim*

out of the statement of the House Managers submitted with the first Conference Report and those words must have been intended to retain the meaning in which they already had been used. There is nothing to indicate that the words were intended to have a broader meaning. On the contrary, the statement of the House Managers submitted with the second Conference Report contains identically the same explanation of the effect of the original House bill, the effect of the Senate amendment and the effect of the amendment then being recommended, as they had submitted in connection with the first Conference Report.

The explanation of the change made in the limitation provision after the Conference Committee had made its first report is doubtless as follows. The Conferees must have felt that the provision first recommended by them (a claim "shall be treated as a claim ranking on a parity * * * *in an amount equal to*" three years' rent) might lead to the contention that every landlord should have a claim equal to three years' rent, without being required to establish the amount of his claim by proof. It was in order to avoid such a contention and to make it clear beyond dispute that every landlord would be required to prove the amount of his claim, that the language first recommended was abandoned.

If the Conference Committee had intended, in either its first or second report, to go beyond the conflict between the original House and Senate provisions and to recommend so radical a change as the destruction of any part of the landlord's claim, it is reasonable to assume that the House Managers would have made some statement to that effect.

The Court of Appeals refused to be guided by the legislative history outlined above because of the significance which it attributed to the omission from the final bill of the clause contained in the Senate bill expressly subordinating the balance of the landlord's claim over one year's rent to provable debts, apparently believing that that clause had expressly provided for the subordinate *allowance* of the balance of the claim and that its final omission must have reflected a contrary intention (R. 153). But the subordination clause did not provide expressly for the *allowance* or recognition of the balance of the landlord's claim; it provided merely for its *subordination*. The clause was mere surplusage, since without its inclusion the balance of the claim over one year's rent was allowable but was required to be subordinated, in view of the express provision that the claim should not be treated on a parity, except up to an amount equal to one year's rent. That the clause was omitted only because it was deemed surplusage is shown by the fact that its omission was first recommended in the first Conference Report in which a substitute provision was recommended which, as we have shown, clearly limited only the parity ranking of landlords' claims. Thus, the Conference Committee, in recommending the omission of the subordination clause, could not possibly have intended the omission to have the significance which the Court of Appeals attributed to it.

Nowhere in the statute can be found the clear and compelling language which is required in order to support the harsh interpretation urged by the respondents. Nowhere in the background or legislative history of the statute can be found even an intimation of an intention by Congress to enact legislation

"for the relief of stockholders" at the expense of bona fide creditors. A subordinate clause in a provision obviously designed as a protection for other creditors ought not to "be given so extravagant an effect" (R. 152).

C. *The General Purpose of Section 77B.*

The general purpose of Section 77B was to provide a practical means of enabling embarrassed corporations to continue business in reorganized form. To this end, the definition of creditors is couched in broad terms and the statute provides, in subdivision (h), that the debtor and its assets shall be freed of all liabilities except such as may be specially reserved (*supra*, p. 5). To construe the statute as not providing for the reservation *in priority to stockholders* of any valid claims not presently allowable would, as we show below (p. 31), raise grave doubts as to its constitutionality. But the attainment of the dominant purpose of the statute—effective reorganization—requires that, so far as practicable, claims should be presently liquidated and allowed, rather than reserved. Therefore, it is not likely that Congress, which knew of the existence of the large lease obligations of many embarrassed corporations, intended that such obligations should be provided for by reservation rather than by present allowance.

III.

If the balance of the claim over three years' rent is not presently allowable the statute requires that the petitioners' rights under the covenant of indemnity be reserved in priority to stockholders, to the extent that their loss turns out to exceed the amount of the allowed claim.

Although the Special Master recommended the present allowance of the petitioners' claim only in an amount equal to three years' rent, his report made it clear that his action was without prejudice to the petitioners' contention that they were entitled to some further recognition in the proceedings in priority to stockholders, either by the subordinate allowance of the balance of their claim or by a reservation of rights (*supra*, p. 7).

Even if the Court of Appeals were correct in holding that the balance of the claim over three years' rent was not presently allowable, that would not require or even support the conclusion, to which the court passed without discussion, that the petitioners' rights were intended to be extinguished for the benefit of stockholders. The limitation provision at the very most relates only to the *allowance* of *claims*. Other provisions of the statute (*supra*, p. 5) recognize that in some instances *liabilities* must be *reserved* in the plan or the order confirming the plan or in the final decree.*

Where the rights to be reserved are subordinate to the rights of creditors whose claims are presently

* In this way the same effect is accomplished in reorganization proceedings as is accomplished in ordinary bankruptcy proceedings by the restriction of the bankrupt's discharge to provable debts.

liquidated and allowed, machinery can be devised for protecting the prior position of such creditors or for valuing the participation in the reorganization which is accorded to the debtor's stockholders and subjecting to the reserved rights only the value of that participation.* (Of course, it may be agreed between the creditors and stockholders, as one of the terms of reorganization, that such rights be reserved generally against the reorganized company.)

Therefore, even if the statute expressly provided, as it does not, that a landlord's claim should not be allowed in an amount in excess of three years' rent, or even that the claim should not be allowed at all, it still would not require or permit the discharge of the debtor and its assets from its contract obligations to the landlord *for the benefit of stockholders.*

If the entire claim is not presently allowable, the alternative interpretation which we are now suggesting is required in order to avoid raising grave doubts as to the constitutionality of the statute (*Interstate Commerce Comm.* v. *Oregon-Washington R. & Nav. Co.*, 288 U. S. 14; *Linder* v. *United States*, 268 U. S. 5) and to avoid the harsh and arbitrary inequalities produced by a contrary interpretation** (*Knowlton* v. *Moore*, 178 U. S. 41, 76-77; *United States* v. *Kirby*, 7 Wall. 482, 486).

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* Adequate machinery was devised to meet such a situation in *In re Mechanics Trust Company, supra.*

** See *infra*, page 39.

IV.

The limitation provision as interpreted by the Court of Appeals is unconstitutional.

Congress was without power to deprive the petitioners of their fundamental rights as creditors, *for the benefit of stockholders.* The bankruptcy clause of the Constitution authorizes no such legislative repeal of fundamental law and, even if within the general scope of the bankruptcy power, the attempted exercise of the power falls under the prohibition of the Fifth Amendment.

The Court of Appeals failed to understand the ground of the petitioners' attack on the constitutionality of the statute, saying that the petitioners' position "presupposes that the appraisal of the future value of real estate is so reliable a basis * * * that Congress was obliged to treat it as good against shareholders" (R. 153).

The petitioners do not urge that the statute is unconstitutional if not requiring the present allowance of their entire claim measured by the formula adopted or by any other formula. (As we have shown, the court itself, and not Congress, selected the formula to be used.) The petitioners recognize that Congress has the power in providing an effective bankruptcy system to exclude contingent claims from liquidation and present allowance, so long as such claims are not extinguished.

Our position is that, if the petitioners' claim is not presently allowable in excess of three years' rent, then the failure of the statute as interpreted below to preserve as against stockholders the petitioners' contract right to indemnity, to the extent that their loss turns out to exceed three years' rent, renders

the statute unconstitutional. The petitioners' complaint is that in reorganization proceedings their contract rights have been partially appropriated for the benefit of their debtor's stockholders by "legislative fiat". They complain that what has been offered them in return, which the Court of Appeals called a "truncated substitute" measured by a "pie-powder standard", is arbitrary and discriminatory.*

A. *The Bankruptcy Clause.*

There was nothing in the practical situation with which Congress was dealing in the enactment of Section 77B (see *Duparquet etc. Co.* v. *Evans*, 297 U. S. 216) which required the legislative repeal of the fundamental principle that the priority of creditors (however contingent their claims may be) over stockholders could not be evaded by any form of corporate reorganization (*Northern Pacific Ry. Co.* v. *Boyd, supra; Kansas City Terminal Ry. Co.* v. *Central Union Trust Co.*, 271 U. S. 445; *Howard* v. *Maxwell Motor Co., Inc., supra*).

Even if the inherent nature of claims justifies their partial exclusion from present allowability *on a parity with other debts,* that does not necessitate the extinguishment of the unallowable portion of the claims *for the benefit of stockholders.* Contingent claims may be allowed or reserved in subordination to other debts but in priority to the interests of stockholders (*Block* v. *Bell Furniture Co., supra*), and corporations may be reorganized effectively without according

* Judge Learned Hand's description was quite apt. The decision below certainly "mutilated" and "lopped off" the petitioners' rights. If Congress intended to prescribe such a remedy, it well may be said that it had assumed the role of a medieval squire settling disputes at country fairs according to his own ideas of rough justice.

stockholders a participation at the expense of a single class of creditors.

The limitation provision as interpreted below is not reasonably adapted to the object in view—effective reorganization. As we have shown, it does not provide a ready method for the liquidation of landlords' claims, but requires a judicial determination of the total claim before the limitation, whatever may be its effect, may be applied. No time, trouble or expense is saved in the judicial determination of the total amount of landlords' claims; in fact, the application of the arbitrary yardstick merely adds a further operation to the task of liquidation. If by "effective reorganization" is meant a readjustment fairly preserving the relative positions of creditors and stockholders, the arbitrary limitation of the claims of certain creditors defeats the end in view.

In the Court of Appeals, the trustee urged that the instant case is ruled by the decision of this Court in *Norman* v. *Baltimore and Ohio R. Co.*, 294 U. S. 240. That argument, if followed to its logical conclusion, would lead necessarily to the establishment of the proposition that in the exercise of the bankruptcy power Congress may destroy ordinary contract rights against a solvent corporation for the benefit of its stockholders, without any compensation whatever. But it cannot be said that covenants contained in leases entered into by an ordinary business corporation, obligating it in certain events to pay damages or to indemnify its landlords against loss of rents, were afflicted with a "congenital infirmity" (294 U. S. at p. 304) which would have permitted Congress to abrogate them entirely for the benefit of the corporation's stockholders when it thereafter voluntarily sought reorganization. There is nothing in the lan-

guage of the statute or in the Committee reports or the debates which evidences a determination by Congress that even the partial destruction of such covenants *for the benefit of stockholders* was necessary to the effective reorganization of corporate tenants.*

As to the petitioners, the statute has been given a retroactive effect. There is not a mere incidental impairment resulting from the exercise of an admitted power; there is a direct taking, *pro tanto,* of all remedies and therefore of the contract itself (*Lynch* v. *United States,* 292 U. S. 571; *Gibbes* v. *Zimmerman,* 290 U. S. 326). It is no answer to say that no cause of action had accrued to the petitioners under their contract of indemnity, since their loss could not be ascertained until the end of the term. No cause of action had accrued to the creditor for the enforcement of the liability of a state bank's stockholders, in *Gibbes* v. *Zimmerman.* Yet this Court, while holding that the creditor had no property, in the constitutional sense, in any particular form of remedy for enforcing the stockholders' liability, spoke of his "substantial right to redress by some effective procedure" as guaranteed by the Fourteenth Amendment, thus recognizing such right as property. See, also, *Pierce* v. *United States, supra.*

Although the petitioners had no title or lien with respect to any specific property of the debtor at the time of the enactment of Section 77B, they had definite, specific rights with respect to *all the property of the debtor,* to the exclusion of the debtors' stockholders. The debtor was in bankruptcy. Its surplus assets remaining after the satisfaction of its

* No such limitation on landlords' claims was attempted in the enactment of the provisions for the relief of individual debtors (Sec. 74), or of railroad corporations (Sec. 77), or of municipal corporations (Sec. 80).

provable debts constituted a trust fund, none of which could have been distributed to stockholders to the prejudice of the petitioners. If the debtor had been wound up under the statutes of New Jersey (the state of its incorporation), the petitioners' rights against the surplus assets would have been protected fully either by the present allowance of their claim or by the impounding of the assets until the petitioners' actual loss could be ascertained (*Block* v. *Bell Furniture Co., supra; cf. Pierce* v. *United States, supra*). If the debtor had been reorganized through the machinery of a bankruptcy sale, any interest accorded to the stockholders on such reorganization likewise would have constituted a trust fund for the protection of the petitioners' rights (*Northern Pacific Ry. Co.* v. *Boyd, supra; Howard* v. *Maxwell Motor Co., Inc., supra*). The petitioners' right to priority over stockholders with respect to any disposition of the debtor's estate, and their pre-existing remedies for the enforcement of that right, are as fully entitled to constitutional protection as were the rights and remedies in *Louisville Land Bank* v. *Radford*, 295 U. S. 555.

Even if it could be said that some reasonable and ratable limitation of contingent, unliquidated claims for the benefit of stockholders is necessary or reasonably adapted to effective reorganization (which we deny), that would not advance the argument in support of the decision below. The arbitrary and unequal operation of the limitation on landlords' claims as interpreted below is discussed fully at pages 39-44, *infra*.

There is no relation whatever—certainly no reasonable relation—between the amount of three years' rent agreed to in a lease entered into many years ago and the present value of an agreement to indemnify

against loss of rents during a term which, as in the case at bar, has fourteen years to run. The only ground on which the Court of Appeals thought the limitation to three years' rent had a "rational relation to the end to be achieved" was that it ordinarily would permit a landlord to prove his losses for "four or five years" which, in view of the supposed difficulty of determining the "future value" of real property, the Court thought was "a period which Congress *might* well fix as the maximum forecast which it would be safe to act on" (R. 154). To this assumption there are several answers: (1) the limitation provision does not restrict landlords' losses or the liquidation of landlords' claims to any particular period (*infra*, pp. 39-41); (2) the liquidation of landlords' claims does not involve forecasting *future* values of real property; it is the *present rental value* for the unexpired term which is involved (*supra*, p. 14); (3) other claims equally or more difficult of liquidation are allowable in full (*infra*, p. 44); and (4) if claims may not be liquidated properly, that is no reason for extinguishing them for the benefit of stockholders (*supra*, p. 29).

Moreover, the limitation provision applies to all landlords' claims, irrespective of whether or not they may be supposed to be difficult of liquidation. As to claims concededly not involving difficulties of liquidation,* the provision clearly is beyond the bank-

* Landlords' claims may arise under covenants providing for the payment of liquidated damages measured by the formula which the Court of Appeals adopted for the liquidation of the petitioners' claim. Other claims concededly not involving any difficulty of liquidation may arise; *e. g.*, where a landlord had erected a building especially for the tenant's use or had paid a bonus to cancel a prior lease in order to give possession to the tenant, and a covenant had been inserted in the lease requiring the tenant, in the event of early termination, to pay the landlord as liquidated damages an amount equal to the unamortized portion of the landlord's expense.

ruptcy power, and since in this respect the provision is single and indivisible it cannot be upheld as to the petitioners' claim, even if it would be valid had it been restricted to claims of that character (*Illinois Central R. R. Co.* v. *McKendree*, 203 U. S. 514, 528; *The Employers' Liability Cases*, 207 U. S. 463, 496-501, 504).

Although we concede that the scope of the bankruptcy power has never been delimited by decision of this Court, it may be helpful to point out the novelty of the provision under discussion and its radical departure from anything heretofore attempted.

In *Louisville Land Bank* v. *Radford, supra*, this Court said of the Frazier-Lemke Act that no bankruptcy act had ever before undertaken to supply the bankrupt capital with which to engage in business in the future. That remark is fully applicable to a provision which transfers to a corporation's stockholders an interest of substantial value constituting a trust fund for a certain class of its creditors.

Nor has any bankruptcy act ever before attempted to discharge the debtor from liability on any claim not fully provable and entitled to share in the distribution of assets, the privilege of provability and the privilege of discharge always having been deemed, from the earliest times, "co-extensive and commensurate, and very equitable" (*Ex parte Groome*, 1 Atkins 115, 119). Moreover, discharge affects only the subsequent property acquisitions of the bankrupt, freeing him from "encumbrance on future exertion"; it does not free his existing assets (*Hanover National Bank* v. *Moyses*, 186 U. S. 181, 188, 192).

The provisions of bankruptcy acts authorizing compositions are not analogous. A composition can be

effected only with the consent of the class of creditors affected thereby and if judicially determined to be for the best interest of such creditors, after notice and opportunity to be heard. The limitation of landlords' claims applies inexorably, even over the protest of every landlord creditor, irrespective of the special facts and circumstances of the particular case and without any power in the court to determine or even consider its fairness (*cf. W. B. Worthen Co.* v. *Thomas,* 292 U. S. 426, 431; *National Surety Co.* v. *Coriell,* 289 U. S. 426; *First Nat. Bank* v. *Fleishem,* 290 U. S. 504, 525).

The arbitrary limitation of landlords' claims cannot be justified by reference to the power of Congress to recognize exemptions designed to afford some reasonable measure of relief to *individual* bankrupts. It is a benefit conferred on the stockholders of business corporations, which, unlike the usual exemptions, is not contributed *pro rata* by all creditors or even by all creditors with contingent, unliquidated claims, but is exacted entirely from one class of creditors arbitrarily selected under an inexorable rule (*infra,* p. 44). "The exemption * * * is unlimited. * * * There is no restriction with respect to particular circumstances or relations" (*W. B. Worthen Co.* v. *Thomas, supra,* at p. 431.) Moreover, retroactive exemptions are invalid (*Gunn* v. *Barry,* 82 U. S. 610; *Edwards* v. *Kearzey,* 96 U. S. 595; *In re Dillard,* Fed. Cas. No. 3912).

B. *The Due Process Clause.*

The bankruptcy power is subject to the limitations of the Fifth Amendment (*Louisville Land Bank* v. *Radford,* 295 U. S. 555, 589).

Even if the limitation of landlords' claims *for the benefit of stockholders* were within the general scope of the bankruptcy power—which we deny—the limitation here attempted, as interpreted below, is invalid. It is a "legislative decree", and is arbitrary and discriminatory.

(1) *The limitation provision is arbitrary and discriminatory.*

The inequalities and arbitrary discrimination produced by the statute are not incidental, occasional or only remotely possible, but are deliberate, "inevitable and profound" (*Knowlton* v. *Moore, supra*).

As to claims based on leases containing covenants to indemnify against loss of rent: If the proper formula for evaluating such claims is the difference between rent reserved and rental value, as we contend and as was held below, the three factors which enter into the equation are (1) the annual rent reserved; (2) the length of the unexpired term; (3) the present rental value for the unexpired term. The limitation provision takes the first factor, multiplies it by three, a figure selected out of the blue, and prescribes that the arbitrary result thus achieved shall measure the extent of the landlords' rights if it is less than his total claim, but shall be disregarded if it is in excess of his total claim. This arbitrary yardstick is applied after the landlord's entire claim has been judicially determined by the correct application of all relevant factors.

It is only theoretically possible—and then only by purest accident—that the provision can operate

equally as among landlords similarly situated. As the table printed on the opposite page shows, the provision may—almost must—operate unequally between two landlords even where the amounts of annual rent reserved are identical (Cases A and B; C and D); even where the unexpired terms of the leases are identical (A, B and C; E and F); even where the present rental values of the unexpired terms are identical (B and C; D and E); and even where any two of these three factors are identical (A and B; B and C); or where the total damages (D, E and F), or the respective ratios of total damage to total rent reserved (C, D and E), are identical.

In every case, irrespective of the identity of all other factors, the determining factor is three times the amount of the annual rent which happens to have been agreed upon when the lease was made, perhaps many years ago. Under that standard, one landlord's losses may be allowed for five years while the losses of another are allowed for twenty years. A more arbitrary, unrelated standard scarcely could be imagined. It necessarily produces wholesale inequalities.* Such inequality may not be sustained

* It has been said that the longer the unexpired term, the less chance there is of the landlord ultimately sustaining loss. This is specious; it ignores the fact that the landlord is not required or even permitted to speculate as to the future trend of rental values for the account or at the risk of the tenant. He is entitled and even required to replace his bargain as quickly as that can be done, by re-letting the premises for the entire balance of the term. If he has been unable to do so, opinion evidence as to the price which could have been obtained on such a re-letting must be resorted to. If he could have re-let for the balance of the term and failed or refused to do so, he nevertheless is chargeable with the amount obtainable, in computing his claim (*supra*, p. 14, footnote).

Aside from these considerations, the limitation provision does not discriminate only against landlords where the unexpired terms of their leases are long. It may also discriminate against landlords whose leases are short in favor of others whose leases are long (Cases A, D and F).

	A		B		C		D		E		F	
Unexpired term	10 yrs.		10 yrs.		10 yrs.		6 yrs.		4 yrs.		4 yrs.	
Annual rent	$10,000		$10,000		$12,000		$12,000		$18,000		$15,000	
Total rent reserved		$100,000		$100,000		$120,000		$72,000		$72,000		$60,000
Present rental value		70,000		40,000		40,000		24,000		24,000		12,000
Total damage		30,000		60,000		80,000		48,000		48,000		48,000
Allowable claim (3 yrs. rent)		30,000		30,000		36,000		36,000		48,000		45,000
Destroyed claim		none		30,000		44,000		12,000		none		3,000

(N. B. The above figures are regardless of discount. Substantially similar results would be obtained if the figures for *Total rent reserved* and *Present rental value* were adjusted at the same rate of discount.)

merely because "it is difficult to be just, and easy to be arbitrary" (*Stewart Dry Goods Co.* v. *Lewis*, 294 U. S. 550, 560).

The same unequal results follow even if the landlord's damage under a covenant to indemnify against loss of rents is considered to be, not the difference between rent reserved and rental value, but the actual loss as ascertained at the end of the term. The same unequal results follow as to claims for liquidated damages contracted to be computed by the formula applied in the case at bar. Entirely absurd results follow as to landlords' claims based on covenants to pay damages bearing no relation whatever to the amounts of rent reserved in the leases (see the footnote, p. 36, *supra*).

The Court of Appeals, although recognizing the gross inequalities produced by the statute as among different landlords, upheld the statute by a curious process of reasoning: the court thought (R. 154) that if Congress had limited landlords' claims to their *losses* for four or five years, *that would have been* reasonable, in view of the supposed unreliability of the formula used for measuring their losses; since ordinarily the limitation of claims to three years' rent would permit landlords to prove their losses for at least four or five years, the complaint against the statute is merely that when a landlord's "losses are large he is not treated equally with those whose losses are small". The court concluded that since "no lessor is unjustly treated as against his lessee, this is a complaint to which we are not disposed to lend an auspicious ear", because "nobody should be shocked that in a class of claims like these, so inherently uncertain, a piepowder standard is chosen, *even though it operates unevenly as unquestionably it does*". The court also suggested that only "the

lessee" could complain that some landlords might recover their losses for more than five years and that the lessee could not make this complaint because "he is getting a discharge upon a payment which he cannot show is too great until the occasion is past".

The Court of Appeals ignored the realities of the situation. It is inherent in any scheme of reorganization that every member of each class of creditors and stockholders should receive ratably equal treatment with his fellows in that class. But, under the statute as construed below, as we have shown, only by the merest accident can any two landlords receive treatment ratably proportionate to their losses, whether presently appraised or subsequently ascertained. That is a complaint, therefore, which should be available to any landlord who does not participate to the full extent of his actual loss.

Moreover, the remarks of the Court of Appeals are relevant only to a statute which Congress *might have enacted,* if it had desired to limit all landlords' losses to four or five years—not to the statute actually enacted (see *supra,* p. 16).

Finally, the view that "no lessor is unjustly treated as against his lessee" was based entirely on the assumption that a rough standard of justice must be applied because of the supposed difficulty of ascertaining the "future value" of real estate. To this there are two answers: first, it is a difficulty which affects only the question of whether the entire claim is *presently allowable* (*supra,* p. 29), and second, it is no difficulty even in that connection (*supra,* p. 14).

The statute produces other inequalities and arbitrary discriminations which the Court of Appeals ignored entirely.

The limitation is not applied to the claims of landlords of railroads, municipal corporations or individuals (Bankruptcy Act, Sections 77, 80 and 74). Although landlords' claims in ordinary bankruptcy proceedings were formerly not provable at all and now are provable only up to one year's rent, they were not formerly excluded and are not now limited for the benefit of the bankrupt or the stockholders of a bankrupt corporation.

The provision discriminates against landlords in favor of other creditors whose claims, although equally if not more difficult of liquidation, are not restricted for the benefit of stockholders.

Thus the discrimination against landlord creditors in Section 77B cannot be sustained as a valid classification based on the supposed difficulty of liquidating their claims.*

The arbitrary selection and wholesale discrimination attempted by the limitation provision as interpreted below bring it into conflict with the requirements of due process (*Heiner* v. *Donnan,* 285 U. S. 312, 331; *Nichols* v. *Coolidge,* 274 U. S. 531, 542; *Hoeper* v. *Tax Commission,* 284 U. S. 206; *Truax* v. *Corrigan,* 257 U. S. 312, 331).

(2) *The limitation provision deprives the petitioners of their rights by legislative decree.*

The provision operates automatically—without regard to the condition of the debtor, the extent of the

* It often has been urged that the landlord is a logical choice for discrimination, *because he gets his property back.* But the discharged employee is free to obtain new employment, and the holder of a forward contract for the sale of chattels has never even parted with his property;—yet these creditors participate in full. The landlord's claim, like their claims, is merely for the loss of his bargain.

stockholders' equity or any other particular circumstances of the case (*cf. Lowden* v. *Northwestern Nat. Bank & Trust Co.*, 298 U. S. 160). The judge has no discretion as to limiting landlords' claims. A landlord is not permitted to show that, under the circumstances, it would be unfair to limit his claim for the enrichment of the stockholders of a solvent corporation. On the question of whether the limitation is fair and equitable under the circumstances the landlord does not have a day in court or a hearing of any kind (*cf. National Surety Co.* v. *Coriell, supra*; *First Nat. Bank* v. *Flershem, supra*). "This is not legislation. It is a decree under legislative forms" (*Loan Ass'n* v. *Topeka*, 20 Wall. 655, 664). It is legislative usurpation of judicial power (*Louisville &c. Bank* v. *Radford, supra; Heiner* v. *Donnan, supra; cf. W. B. Worthen Co.* v. *Thomas*, 292 U. S. 426).*

If the limitation provision were intended as a short-cut method of liquidating landlords' claims, it still would be invalid. The determination of compensation for property taken and ordinarily the determination of damages are judicial functions (*Monongahela Navigation Co.* v. *United States*, 148 U. S. 312; *East Kingston* v. *Towle*, 48 N. H. 57). The admitted principle that where great difficulties inhere in the ascertainment of actual damages, the Legislature may provide, as to the future, for liquidated damages reasonably approximating the probable actual

* In *Louisville Land Bank* v. *Radford, supra*, the automatic extension of five years provided in the Frazier-Lemke Act was distinguished (pp. 596-598 of 295 U. S.) from the maximum extension of 2 years to be determined by the court, as provided in the Minnesota moratorium statute. In *Heiner* v. *Donnan, supra*, the legislative conclusive presumption that transfers within two years of death should be deemed to have been made in contemplation of death was held unconstitutional.

damages does not support the decision in the case at bar. The limitation on the claim of these petitioners is retroactive and the formula adopted bears no relation whatever, reasonable or otherwise, to the probable actual loss, whether that loss be estimated at the difference between rent reserved and rental value or its ascertainment be required to await the event.

It is clear, however, that the limitation provision does not purport to provide for liquidated damages. As we have shown, it does not assure every injured landlord of a claim equal to three years' rent, nor was it intended to assist in the ascertainment of any landlord's claim or injury. As interpreted below, the provision is and was intended to be merely a "truncated substitute", viz., a lopping off of all but a predetermined portion of claims already liquidated (and intended to be liquidated) by judicial process. We have found only one precedent for such an attempt. An early Pennsylvania statute undertook to limit certain claims for damages for personal injuries to the sum of $3,000. It was held to deny the right to a "remedy by due course of law" guaranteed by the Pennsylvania constitution (*Kay* v. *Pa. R. R. Co.*, 65 Pa. St. 269; *Passenger Rwy. Co.* v. *Boudrou*, 92 Pa. St. 475).

V.

The petitioners are entitled to question the constitutionality of the limitation provision as interpreted below.

Various objections have been advanced to the petitioners' standing to attack the constitutionality of the limitation provision. These objections fall generally

under two heads: (1) as to whether the petitioners are or will be damaged by the operation of the provision, and (2) as to whether the petitioners have waived, or are estopped to assert, the unconstitutionality of the provision.

A. *The Limitation Provision, as Interpreted Below, Inflicts Legal Injury on the Petitioners.*

In its brief in opposition to the petition, the trustee urged that the petitioners cannot show at the present time that they are in immediate danger of direct injury, because it cannot be established until the end of the term whether the amount of three years' rent is equal to or less than their actual loss. No method is available for presently evaluating in dollars and cents the petitioners' contract right to indemnity, other than the formula adopted below and universally accepted. It already has been shown that, if that method be adhered to, three years' rent does not equal the petitioners' actual loss. But if the trustee's contention were sound, it necessarily would follow that the question of constitutionality could not be determined until the amount of the petitioners' actual loss could be established. Therefore, the order now being reviewed is clearly wrong, in that it has cut off the petitioners' rights prematurely without reserving to them a seasonable opportunity of asserting their constitutional rights.

In overruling the petitioners' contention that the limitation provision as interpreted below deprived them of property without due process of law, the Court of Appeals said (R. 156):

> "But before holding that the substitute was here inadequate we must look at the position in

which these lessors would have found themselves if there had been no reorganization."

The Court of Appeals then proceeded to speculate as to the practical value of the petitioners' rights against the debtor prior to the enactment of Section 77B, saying that, since the debtor was already in default and subject to dismemberment by its creditors, and the petitioners' claim was not yet suable, their rights against the debtor in the absence of reorganization would have been "no better than if it were out and out insolvent." This reasoning is similar to the argument which was advanced unsuccessfully in the *Boyd* case, that the assets involved in that reorganization were insufficient to pay the mortgage debts, leaving nothing of value for general creditors. In that case this Court said that the superior rights of creditors over stockholders "must be decided according to a fixed principle, not leaving the rights of the creditors to depend upon the balancing of evidence as to" the value of the property, and that if the value of the property justified the issuance of securities to the stockholders "the creditors were entitled to the benefit of that value, whether it was present or prospective, for dividends or only for purposes of control", since "in either event it was a right of property out of which the creditors were entitled to be paid before the stockholders could retain it for any purpose whatever" (228 U. S. at pp. 507-8).

There has been no finding that the debtor is insolvent nor has its insolvency even been alleged. There is no basis whatever in the record to support the assumption of the Court of Appeals that the amount of immediately enforceable liabilities was so great that the debtor's dismemberment would have resulted from their enforcement, leaving no surplus which

would have constituted a trust fund for contingent creditors such as the petitioners. The order of the District Court limiting the petitioners' rights to participate in the debtor's reorganization was entered in the absence of any determination of the total amount of claims and in the absence of any determination of the value of the assets, and the only theory on which it could have been entered at that time was that those facts were entirely irrelevant to the issue. In this respect, the order refused to follow the report of the Special Master who attempted to defer the determination of the petitioners' rights in excess of three years' rent until the time arrived for the classification of creditors and the adoption of a plan of reorganization.

The petitioners are asking only that their claim in excess of three years' rent be allowed in priority to whatever interest otherwise might be available for stockholders, or that the order cutting down their claim to three years' rent be without prejudice as against stockholders. That is their fundamental right and they are not required to prove its value in dollars and cents in order to prevent being deprived of it. However, the insistence of the Preferred Stockholders' Protective Committee on the limitation of the petitioners' rights solely for the benefit of stockholders, as shown by the record, justifies the inference that the priority over stockholders for which we contend is not entirely without value.

B. *The Petitioners Have Not Waived, and Are Not Estopped to Assert, the Unconstitutionality of the Limitation Provision.*

In its brief in opposition to the petition, the trustee urged that the petitioners have no standing to chal-

lenge the constitutionality of the limitation provision because they "have accepted the benefit of the statutory scheme of liquidation". This means that the petitioners are estopped to question the partial destruction of their contract rights because they have demanded that they be allowed to prove, on a parity with provable debts, a claim in the amount of three years' rent, and because the courts below have upheld that position and the petitioners have not appealed.

The contention is wholly without merit. In their proof of claim, the petitioners followed the requirements of the statute as they understood it. It is true that they demanded that their entire claim be liquidated at the difference between rent reserved and rental value and that their claim be allowed on a parity with provable debts in an amount equal to three years' rent. But at the same time the petitioners also demanded that the balance of their claim be allowed in subordination to provable debts but in priority to the interests of stockholders (R. 4). Later, with the consent of all parties, the petitioners amended their proof of claim so as to demand that if any part of their claim should be held not provable their rights should, to that extent, be reserved against the debtor's assets, at least in priority to the interests of stockholders (R. 25).

Throughout the proceedings, the petitioners have asserted that the limitation provision is unconstitutional if interpreted as it was below.

The petitioners have as yet accepted nothing under the statute. The position which they have urged throughout the litigation has been upheld in part by the lower courts. There was no necessity on their part, nor had they any standing, to appeal from the order in so far as it was in their favor.

The preferred stockholders and the debenture-holders did appeal and urged in the Court of Appeals, as they had in the District Court, that the petitioners had no claim entitled to allowance in any amount. After their contentions were overruled by the Court of Appeals, they failed to apply for certiorari, and thus it may be that the question of the allowability of the three-year claim is not before this Court.* However, that is the result of the respondents' voluntary abandonment of their position below and cannot in any way prejudice the petitioners' rights in this Court.

If the respondents had brought the whole case to this Court, they might have been in a position to urge that the statute offered the petitioners an election either to prove a claim for three years' rent on a parity with provable debts, or to reserve in full their contract rights. If such a contention (which goes merely to the *interpretation* of the statute) had been made and upheld, the petitioners then would have been required to elect; up to the present time, they have made no election, nor have they been required to make one. Certainly the statute did not afford them the choice of either accepting its benefits or of failing to file a claim and later attacking its constitutionality.

Whatever might have been the result if the whole case had been brought to this Court, it is clear that in the existing situation the provision which the petitioners are entitled to receive under the decision below is only something to which they would be entitled in any event, irrespective of what interpretation may be placed on the limitation provision and irrespective of whether or not it is determined to be constitutional. There is no basis whatever for an estoppel.

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* The trustee has never questioned the petitioners' right to the three-year claim.

VI.

As to the relief to which the petitioners are entitled.

Ample evidence was adduced before the Special Master to enable him to determine the total amount of the claim, and he failed to do so only because he felt that all questions as to the petitioners' claim in excess of three years' rent should be reserved for future determination.

On this record, the order below should be reversed and

(a) the balance of the petitioners' claim over three years' rent, amounting to $43,314.75 (subject to discount), should be allowed in subordination to provable debts but in priority to the interests of stockholders;

or

(b) the disallowance of the balance of the petitioners' claim over three years' rent should be without prejudice to the right of the petitioners to demand appropriate reservation of their rights in priority to the debtor's stockholders, either in any plan of reorganization which may be confirmed by the District Court, or in the order confirming such plan, or in the final decree.

Respectfully submitted,

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